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IN THE
Supreme Court of the United States
OCTOBER TERM, 1982

GLEN CORPORATION, *et al.*,
Petitioners,
v.
O.C. ASSOCIATES, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the First Circuit

PETITIONERS' REPLY BRIEF

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PETITIONERS' REPLY BRIEF

Respondents, though arguing the merits at length, have not cited a single precedent supporting their contention that the Bankruptcy Act creates a right to post-petition interest on a claim for unpaid interest, or on any other claim, that overrides contrary applicable state or federal nonbankruptcy law. There is no dispute that under New York law, regardless of a debtor's solvency, respondents had no right to the interest on claims for unpaid interest that the court of appeals awarded. The parties have joined issue on a single clear-cut, yet significant question of federal bankruptcy law. Petitioners respectfully suggest that this case is therefore worthy of certiorari, and even appropriate for summary reversal.

1. Respondents Cite No Authority For Their Contention Concerning The Central Issue—Whether the Bankruptcy Act Creates A Right To Interest On Claims For Unpaid Interest Where None Exists Under Applicable Nonbankruptcy Law

Respondents rely on the principle quoted in the *New Haven* case:

> "[I]f the bankrupt is solvent and there is a surplus after payment of all claims, creditors should receive interest *on their interest-bearing claims* rather than having the surplus turned over to the debtor." [1]

But under this principle, the central issue is whether the portions of respondents' claims representing unpaid interest were themselves "interest-bearing." Petitioners contend that applicable nonbankruptcy law determines whether a claim is interest-bearing; under applicable nonbankruptcy law here, the claims for unpaid interest were admittedly not interest-bearing because of governing state law.[2] Respondents contend that they were interest-bearing because something in the Bankruptcy Act made them so. Despite respondents' lengthy arguments, they do not cite one case under the Bankruptcy Act (or its predecessors or related statutes) where a court awarded interest, on a claim for unpaid interest or on any other claim, when the claim for such interest was expressly barred by applicable nonbankruptcy law.

Vanston Bondholders Protective Committee v. Green, 329 U.S. 156 (1946), the centerpiece of respondents' argument, O.C. Brief at 8-9, illustrates this precisely. The *Vanston* Court "assum[ed], *arguendo*, that the obligation for interest on interest is valid under [applicable state] law . . . ," 329 U.S. at 162, in a passage respondents ignore. The Court had no need to make any such assumption under respondents' theory that bankruptcy law alone is the source of an overriding right to post-petition interest on claims for unpaid interest. Their theory cannot survive the fact that the Court found it necessary to do so.[3]

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[1] *In re New York, New Haven & Hartford Railroad*, 4 B.R. 758, 798 (D. Conn. 1980), quoted in Brief for Respondent O.C. Associates ("O.C. Brief") at 19 (emphasis added).

[2] Both the District Court and the Court of Appeals so found. Petitioners' App. A at 14a; App. B. at 20a-21a. Respondents did not seek review of that finding.

[3] *Vanston* is thus totally at odds with respondents' contention that "state law has nothing to do with this question." O.C. Brief

To support their contention and deny any conflict among the circuits, respondents allege that the vitality of two Second Circuit cases[4] declining to award post-petition interest in bankruptcy on claims for unpaid interest where barred by state law is undermined by two later opinions of that court. O.C. Brief at 13-14; D.P.C. Brief at 9. This allegation is completely unfounded. One of the two cases, *Corbin v. Federal Reserve Bank*, 629 F.2d 233 (2d Cir. 1980), *aff'g* 475 F. Supp. 1060 (S.D.N.Y. 1979), *cert. denied*, 450 U.S. 970 (1981), had nothing to do with state law; the district court explicitly held that the claim at issue was governed by, and valid under, federal banking law.[5] Respondents contend that in the second case, *Ruskin v. Griffiths*, 269 F.2d 827 (2d Cir. 1959), *cert. denied*, 361 U.S. 947 (1960), the Second Circuit "never once mentioned the question whether the agreement [for an increased rate of interest in the event of bankruptcy] was valid under state law." O.C. Brief at 13. Not so. The Second Circuit specifically held there that the provision in question was neither a penalty nor unconscionable, citing two New York cases.[6] The First Circuit, in fact, recognized that *Ruskin* concerned the enforcement of a contractual provision *valid* under state

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at 8 (footnote omitted). State law matters whenever federal non-bankruptcy law does not. It should be clear that this case has nothing to do with whether *Vanston* would allow denial of interest on interest if respondents had a valid claim to it. Respondents' extensive discussion of this question, O.C. Brief at 8, 9, 13, 14, 16 & n.21, 19 n.25; Debentureholders Protective Committee ("D.P.C.") Brief at II, is wholly beside the point.

[4] *In re Realty Associates Securities Corp.*, 163 F.2d 387 (2d Cir.), *cert. denied*, 332 U.S. 836 (1947); *Empire Trust Co. v. Equitable Office Building Corp.*, 167 F.2d 346 (2d Cir. 1948).

[5] 475 F. Supp. at 1070. The court of appeals incorporated the district court's opinion by reference. 629 F.2d at 235.

[6] The court cited *Union Estates Co. v. Adlon Const. Co.*, 221 N.Y. 183, 116 N.E. 984 (1917) (upholding, under New York law, similar provision on same grounds), and compared it with *Newburger-Morris Co. v. Talcott*, 219 N.Y. 505, 510, 114 N.E. 846 (1916) (leading case on invalidity of contractual provision for interest on interest under New York law). 269 F.2d at 832.

law, rather than a provision, as here, that all parties concede is *invalid* under state law. Petitioners' App. A at 10a.

Every other even arguably relevant case respondents cite falls into one of the two following categories:

- The validity of a claim for an award of interest was determined under either federal nonbankruptcy law or state law.[7]
- The interest-bearing quality of the claim was unchallenged.[8]

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[7] *Ticonic National Bank v. Sprague*, 303 U.S. 406, 410 (1938) (Court found right to interest, citing two nonbankruptcy cases, before discussing whether secured creditor was entitled to receive that interest); *American Iron & Steel Mfg. Co. v. Seaboard Air Line Rwy.*, 233 U.S. 261, 264-65 (1914) (Court determined claim interest-bearing under state law) (discussed at Petition at 9-10; not cited by respondents); *In re Maryvale Community Hospital, Inc.*, 456 F.2d 410, 413-14 (9th Cir. 1972) (valid under Arizona law); *Speare v. Consolidated Assets Corp.*, 367 F.2d 208 (2d Cir. 1966) (following New Jersey usury law, claimant entitled to return of principal, but, if principal was tendered, not to any interest on principal, pre- or post-petition); *In re International Hydro-Electric System*, 101 F. Supp. 222, 223-25 (D. Mass. 1951) (valid under Massachusetts law).

[8] *Ecker v. Western Pacific R.R.*, 318 U.S. 448 (1943) (secured creditors awarded interest where contracts provided for it; senior secured creditor whose contract provided for no interest received none); *Consolidated Rock Prods. v. Du Bois*, 312 U.S. 510, 514-15 (1941); *Case v. Los Angeles Lumber Prods. Co.*, 308 U.S. 106, 109-10 (1939); *Northern Pacific Rwy. v. Boyd*, 228 U.S. 482 (1913), *aff'g* 177 F. 804, 806 (9th Cir. 1910); *Coder v. Arts*, 213 U.S. 223, 225 (1909) (brief for appellant there concedes that claim was interest-bearing); *Muskegon Motor Stockholders Protective Comm. v. Davis*, 366 F.2d 522 (6th Cir. 1966); *Palo Alto Mutual Savings & Loan Assoc. v. Williams*, 245 F.2d 77, 78-79 (9th Cir. 1957); *Eddy v. Prudence Bonds Corp.*, 165 F.2d 157, 160 (2d Cir. 1947), *cert. denied*, 333 U.S. 845 (1948); *Mortgage Loan Co. v. Livingston*, 78 F.2d 517, 518 (8th Cir.), *cert. denied*, 296 U.S. 607 (1935); *In re Imperial '400' National Inc.*, 374 F. Supp. 949, 954 (D.N.J. 1974) (SEC found New Jersey law governed award of interest where no interest rate specified in contract, 45 S.E.C. 36, 46 n.42 (1972); district court adopted SEC approach, 374 F. Supp. at 954 & n.9); *In re New York, New Haven & Hartford Railroad*, 4 B.R. 758, 770 (D. Conn. 1980).

Not one of these cases even hints that federal bankruptcy law plays any role in determining whether a claim for unpaid interest, or any other claim, is interest-bearing.[9]

The *only* exception is the instant case, which reaches the result dictated by respondents' theory, but does not accept the theory itself. Respondents contend here, as they contended below, that the absolute priority rule made the interest portion of their claims interest-bearing.[10] They cite no support for the proposition that the absolute priority rule, a rule of distribution, has ever been interpreted to create such substantive rights. Judge Wyzanski below, in fact, used the absolute priority rule only after determining that some *other* rule of bankruptcy law made the claims interest-bearing.[11] He cited three cases to support the existence of this other "rule," *see* Petitioners' App. A at 15a. Petitioners demonstrated that none of

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[9] Respondents also cite two cases not even arguably relevant because they were decided under the Bankruptcy Code. *In re Marz*, 11 B.R. 819 (S.D. Ohio 1981), involved a valid contractual provision for interest. *In re Lum*, 1 B.R. 186 (E.D. Tenn. 1979), awarded not interest on a claim, but interest on post-confirmation installment payments. Were these cases relevant, they would not support respondents' argument.

[10] O.C. Brief at Part II; D.P.C. Brief at 5. Respondents carefully ignore the absence of support for this proposition in this Court's leading absolute priority rule cases. *See, e.g., Ecker v. Western Pacific R.R., supra*, and *Consolidated Rock Prods. v. Du Bois, supra*. *Compare* Petition at 14-15 *with* O.C. Brief at 15.

[11] Petitioners' App. A. at 16a. Respondents assert that the First Circuit's decision does not conflict with this Court's decision in *Butner v. United States*, 440 U.S. 48 (1979), because "unlike *Butner*, Congress *has* created a 'federal rule' applicable to this case: the statutory 'fair and equitable' rule for distributions. . . ," O.C. Brief at 20; see D.P.C. Brief at 7-8 (*Butner* inapposite because First Circuit merely applied absolute priority rule). Since the First Circuit did not rely on the absolute priority rule to make these claims interest-bearing, but relied instead on some other "general rule of federal bankruptcy law," the result in the case below avoids conflict with *Butner* only if this Court determines that the absolute priority rule makes claims interest-bearing; no court has ever done so.

these cases supports any such "rule," Petition at 8-10, and even respondents give them short shrift here.[12] Mystery surrounds the source of a federal bankruptcy "rule" making noninterest-bearing claims interest-bearing because there is no such rule.

Respondents apparently feel that applying clearly applicable New York law would produce an inequitable result. While they suggest, O.C. Brief at 26 n.34, that they might have done better to have sought a New York judgment, not even a New York judgment would have produced interest on installments of interest falling due after that judgment, the equivalent of the interest on post-petition interest awarded by the court below. In fact, no judgment was sought either during the eighteen months between the initial default and the filing of the petition for arrangement, or after the filing. The teaching of *Butner v. United States*, 440 U.S. 48 (1979), is that respondents should have sought relief under Bankruptcy Rule 10-601 from the automatic stay of such a state court action; they did not. Any perceived inequity results not from the operation of federal bankruptcy law but from respondents' failure to seek such relief—and, more importantly, from New York law barring interest on interest.

Respondents also make much of the fact that the debtor here proved to be solvent, and that it would be "inequitable" for a solvent debtor to receive anything until all creditors had received interest on their claims for unpaid interest. But the New York law that bars the payment of interest on unpaid interest does not distinguish between solvent and insolvent debtors, and the equity of that rule of law is within the discretion of New York to decide.

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[12] Respondents do not even mention *Littleton v. Kincaid*, 179 F.2d 848 (4th Cir.), *cert. denied*, 340 U.S. 809 (1950). *City of New York v. Saper*, 336 U.S. 328 (1949), and *United States v. Bass*, 271 F.2d 129 (9th Cir. 1959), warrant only a "*see also*" at the end of a string citation, O.C. Brief at 17.

2. The Court Of Appeals' Decision Will Have A Major Impact On Cases Under The Bankruptcy Code

Respondents argue that certiorari should not be granted because the issues have been "mooted by the new Bankruptcy Code." O.C. Brief at 23. They have not been. The First Circuit's decision could have virtually the same effect on cases arising under the new Bankruptcy Code as it already has had on cases under the Bankruptcy Act,[13] because precisely analogous issues arise. Petitioners have already discussed two examples. Petition at 28-29 and n.44. A third example shows this potential effect more directly.

A bankruptcy court under the Code will be required, under certain circumstances, to determine whether a reorganization plan is "fair and equitable."[14] This may require determining whether the plan provides a class of creditors with property equal in value to the "allowed amount" of its claim. 11 U.S.C. § 1129(b)(2). Where a claim involves an invalid indenture provision for interest

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[13] The decision of the court of appeals, in addition to its effect on the 4,000 shareholders in this case, has also adversely affected the position of 25,000 public shareholders of Continental Mortgage Investors in a case arising under the Bankruptcy Act. *See* Memorandum of Paul Lazzaro, Trustee of Continental Investment Corporation, in Support of the Petition.

[14] 11 U.S.C. § 1129(b) (Supp. IV 1980). The Court must do so when a class of claims is "impaired," *see* 11 U.S.C. § 1124, and the class dissents from the proposed plan, 11 U.S.C. § 1129(a)(8). The Code also requires that each member of a class receive not less than the amount it would receive if the debtor were liquidated. 11 U.S.C. § 1129(a)(7)(A)(ii). While the Code requires that in a liquidation creditors receive interest at the "legal rate" before the debtor receives any proceeds, 11 U.S.C. § 726(a)(5), the going concern value typically far exceeds liquidation value. *See, e.g., Muskegon Motor Stockholders Protective Comm. v. Davis, supra*, 366 F.2d at 525; *In re Hollanger*, 15 B.R. 35, 47-48 (W.D. La. 1981); 124 Cong. Rec. 32406, 34006 (1978). Thus, the requirement that creditors receive as much in a reorganization as they would in a liquidation will not itself mandate the payment of interest on creditors' claims for unpaid interest.

on unpaid interest, the court will have to determine whether the "allowed claim" for the unpaid interest is itself interest-bearing. The decision of the First Circuit is squarely on point.

CONCLUSION

For the reasons stated above and in the Petition for Certiorari, certiorari should be granted to review the judgment of the court of appeals, and, if the Court deems appropriate, the decision of the court of appeals should be summarily reversed.

Respectfully submitted,

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